PUBLIC UTILITY VALUATION, THE "UNEARNED INCREMENT" AND THE DEPRECIATED DOLLAR.—Are public utility companies constitutionally entitled to exact rates sufficient to give them a so-called "unearned increment" of land values? Or may regulation, as well as public ownership, protect the consumers from such rates? This question underlies the controversy between reproduction cost and actual cost as the basis for "valuation" in rate cases. The United States Supreme Court has leaned towards reproduction cost, thus saddling the opponents of public ownership with the fortuitous burden of defending the private appropriation of the increment; but this leaning of the Court is manifested almost exclusively in *dicta*,[1] and even there in language so guarded and qualified, and so subject to exceptions,[2] as to leave one in doubt as to the Court's real attitude. Its opposition to actual cost (originally expressed in a case where the original cost was deemed to have been unnecessarily incurred,[3]) is far more evident than is its approval of reproduction cost. Yet, hazy as are the Court's views, and uttered as they are, for the most part, by way of *dictum*, they are none the less important, since the Court has the habit of referring to its own *dicta* in these matters as if they settled the law. Any new pronouncement, therefore, even by way of *dictum*, is to be watched with interest. And a new pronouncement is to be expected on the appeal from the decision of the District Court for the Southern District of New York, in *Consolidated Gas Co. of New York* v. *Newton*.[4]

In that case Judge Learned Hand calculates that the earnings under the statutory 80-cent rate will, under conditions like those of 1918 and 1919 (which he expects to continue for some time in the future[5]) yield less than a 6 per cent. return on what he figures as the lowest justifiable rate-base. He therefore enjoins the continued enforcement of the 80-cent rate. In calculating his rate-base, which he thinks is only about half as large as it ought properly to be (p. 268), he takes a stand on novel grounds in favor of replacement and against actual cost. True, he takes the structures at their original cost, but not with the idea that both original and replacement cost should be "considered". He points out clearly that any such idea merely evades the problem, supported though it be by high authority (pp. 236-237). His idea in taking original cost is to find that evidence of replacement costs which shall be least speculative and most favorable to the statutory rate. The land, however, unlike the structures, he values not at its original cost (except for one tract in Astoria) but at its "present value". True, his other holdings would suffice to brand the 80-cent rate as confiscatory even had he figured land at its original cost.[6] Yet his unqualified *dictum* in favor of replacement cost is

[1] The only exception is the case of *San Joaquin Co.* v. *Stanislaus County* (1914) 233 U. S. 454, 34 Sup. Ct. 652, where a regulation was definitely rejected which would yield a fair return on the actual cost but not on a "water right" for which the company had paid nothing. The case rests on peculiar circumstances, however, the court feeling it necessary to recur "to the fact that in every instance only a few specified individuals get the right to a supply." (p. 460).

[2] In *Des Moines Gas Co.* v. *Des Moines* (1915) 238 U. S. 153, 172, 35 Sup. Ct. 811, for instance, a regulation was sustained which permitted no return on the additional replacement cost brought about by the city's having paved the streets after the mains were laid.

[3] *San Diego Land & Town Co.* v. *National City* (1899) 174 U. S. 739, 19 Sup. Ct. 804.

[4] (1920) 267 Fed. 231.

[5] The case was decided on August 4, 1920, with a supplemental opinion on August 11. It is possible that the very recent decline in price levels might affect his expectation in this regard.

[6] The value of all the land except the Astoria parcel above referred to is

worth considering, not only because, if confirmed, it may commit the Supreme Court more firmly than before to the replacement theory, but also because of the novelty of the arguments with which he supports it.

"The present cost of a substitute plant of equal capacity" is adopted by a process of reasoning which may be reduced to the following syllogism: *Major premise*—"The recurrent appeal to a just rate and a fair value assumes that the effort is to insure such a profit as would induce the venture originally and that the public will keep its faith so impliedly given." (p. 237). *Minor premise*—to induce the original venture, the investor must anticipate a profit whose buying power will not diminish with the depreciation of the dollar. *Conclusion*—The present replacement cost "is a necessary consequence of the foregoing argument." (p. 238).

A very little reflection will show that the conclusion is not the one which follows from the premises. It tacitly assumes that the deviation between the present and the original buying power of the money which the plant actually cost is identical with the deviation between the amount which it actually cost and the hypothetical sum which it would cost to build the plant to-day. But no such assumption is tenable. Other factors than changes in general price levels account for the discrepancy between the original and the reproduction cost. Land in a growing city, for instance, generally appreciates not merely when measured in dollars but when measured in things in general. Owing to its limited supply and the growing demand for it, it appreciates even when no depreciation is taking place in the dollar at all. Yet it is only by identifying present replacement cost with the buying power which the money actually spent had at the time of its expenditure that Judge Hand can say that "a profit based upon the enhanced value of the capital adds nothing in truth at all to the company's wealth. Though its capital be measured in more dollars, and so, too, its profit, that profit is still paid in the fallen dollar, and has no greater buying power than it had before." (p. 237). Elsewhere the Judge seems to scent a distinction between the two concepts, but he does not follow up the scent. In a *dictum* concerning depreciation (pp. 239-240) he implies that "the cost of a present plant of equal capacity", which he is seeking, may be something other than the original cost with abatements "confined to changes in 'price levels' ". He fails to see, however, that the actual cost with additions or abatements corresponding to changes in price levels, easily calculated with the help of index numbers, is the only rate-base which gives the company no greater, and no less, "buying power than it had before." This base, and not the replacement cost, which is much more difficult of ascertainment, is the logical consequence of the Judge's previous argument.

The pronouncement in favor of replacement cost, then, while it has the apparent support of the Supreme Court's *dicta,* is inconsistent with Judge Hand's premises. At least one of the premises, then, must be inconsistent with the Supreme Court's reasoning. Indeed a closer examination of the Judge's ground for deriving his major premise from the Supreme Court discloses the inadequacy of that ground. "The recurrent appeal to a just rate and a fair value," says the Judge in a passage already quoted, "assumes that the effort is to insure such a profit as would induce the venture originally and that the public will keep its faith so impliedly given." Why? De we not find the same recurrent appeal to "just" compensation and a "fair" value in condemnation cases? And who ever supposed that the effort in those cases

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$7,029,035 (p. 268). A 6 per cent. return on this would come to $421,742.10, which, on a spread of 19 billion feet, would come to little over two cents per 1,000 feet.

was to insure to the owner a value measured by the profit which would induce the venture originally? Is not the effort rather to protect him from the loss of whatever advantage our system of ownership chances to give him? The words "just" and "fair" are at least susceptible of a meaning, in the mind of the Supreme Court, which assumes nothing whatever about a profit measured by incentive.

Judge Hand's criterion,—that of the profit necessary to induce the venture,—must commend itself, however, as far more sensible than any criterion out of which the Supreme Court could have deduced the replacement cost rule. It may be that the Supreme Court would not preclude the use of Judge Hand's criterion in cases where notice of the rate-base consistent therewith is given early enough and persuasively enough to prevent the sale of stocks at prices in excess of that base. No such case has come yet before the Court. It may even happen that the Supreme Court will some day wipe clean its blurred slate and will either permit the regulating authorities to follow their own views of policy in the choice of a rate-base, or will write in a new and clean-cut policy of its own. For investments to be made after the new policy is announced, it is difficult to conceive a policy more fitting than that stated by Judge Hand. It is to be hoped that it will be recognized, however, that the adoption of such a policy involves the abandonment, not the confirmation, of the wholly fantastic and unsatisfactory basis of replacement cost. Actual cost, so far as reasonably incurred, modified by index numbers, is the basis which would usually suffice to induce the original venture.

R. L. H.

IS THE DECLARATORY JUDGMENT UNCONSTITUTIONAL?—The Michigan Supreme Court has come to the conclusion that the rendering of a declaratory judgment is not a judicial function, and hence is repugnant to a state constitution providing for the separation of powers. In a recent decision,[1] this result was reached, and at least a temporary impediment put in the way of further reform along this line.

The psychology of the case seems to have had no little part in shaping the decision. The court gave a glimpse of its attitude when it said:[2] " . . . it at once becomes apparent that by the act[3] the courts of this state are made the legal advisors of all seeking such advice . . . in advance of any existing controversy that they be advised by a declaration of rights as to what the law is, or will be in the event of future breaches, future contingencies which may or may not happen. . . . Before this court, with its membership of eight, takes up the work of advising 3,000,000 people . . . it is well that this court pause long enough to consider . . . whether the act calls upon us to perform any duties prescribed by the constitution. . . . " It seems as though the fear of being overburdened may well have had some influence upon the court.[4]

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[1] *Anway* v. *Grand Rapids Ry.* (Mich. 1920) 179 N. W. 350.

[2] *Ibid.*, p. 351.

[3] Mich., Acts 1919, No. 150. The act provides that "no action or proceeding in any court of record shall be open to objection on the ground that a merely declaratory judgment, decree or order is sought thereby, and the court may make binding declarations of rights whether any consequential relief is or could be claimed, or not. . . . " Where further relief becomes proper as a result of such decree, it may be obtained on petition to the court, unless cause is shown by the other party.

[4] Compare with this the statement of an English court when a similar objection was urged by the defendant: " . . . there is no substance in the